

**IN THE MATTER OF THE APPLICATION REGARDING CONVERSION
OF PREMIER BLUE CROSS AND ITS AFFILIATES**

Washington State Insurance Commissioner's Docket # G02-45

PRE-FILED DIRECT TESTIMONY OF:

Brian Kinhead
Banc of America Securities

March 31, 2004

CONFIDENTIAL and PROPRIETARY
NOT FOR PUBLIC DISCLOSURE

Q. Please state your name.

A. My name is Brian Kinkead.

Q. Please state your position and business address.

A. I am a Managing Director in the Healthcare Group of Global Corporate and Investment Banking at Banc of America Securities (“BAS”) in New York. I am a senior banker responsible for providing investment banking services to healthcare service companies, including managed care companies and other healthcare-related entities. The Healthcare Investment Banking Group of Banc of America Securities is located at 9 West 57th Street, New York, New York.

Q. What is the purpose of your testimony?

A. BAS has been engaged by PREMERA, a Washington miscellaneous nonprofit corporation (“PREMERA”), Premera Blue Cross, a Washington nonprofit corporation (“PBC”), and certain of their affiliates (collectively “Premera” or the “Company”) to provide expert opinions in connection with Premera’s proposal to convert from nonprofit to for-profit status (the “Conversion Transaction”), and to then make an Initial Public Offering of securities in the resulting for-profit corporation (“the IPO”). I was the BAS team leader in undertaking the work necessary to arrive at the opinions expressed by BAS.

Q. Has Banc of America Securities submitted an expert report in this proceeding?

A. Yes. BAS filed a report in this proceeding entitled “Opinions as to Market Acceptance and Issues Related to the Proposed Conversion of Premera Blue Cross” dated November 10, 2003 (the “BAS Report”). Our report comments upon the Premera proposal and upon certain of the matters and conclusions contained in reports previously

1 filed by consultants engaged by the staff of the Washington State Office of Insurance
2 Commissioner (the “OIC Staff”). A complete and accurate copy of the BAS Report will
3 be marked as a Premera Hearing Exhibit.

4 On March 5, 2004, we submitted a supplemental report commenting on the
5 revisions to Premera’s Form A filing (the “BAS Supplemental Report”). A complete and
6 accurate copy of the BAS Supplemental Report will be marked as a Premera Hearing
7 Exhibit.

8 I incorporate both the BAS Report and the BAS Supplemental Report into my
9 Pre-filed Direct Testimony by this reference.

10 **Q. Please describe your qualifications and the qualifications of Banc of America**
11 **Securities in connection with the analysis of securities offerings and**
investments in health insurance companies?

12 A. I have been working in investment banking relating to the healthcare industry
13 since 1984. I worked at Morgan Stanley from 1984 until the summer of 2002; when I
14 left, I was the Executive Director, Corporate Finance for Morgan Stanley’s Healthcare
15 Group. I have been involved in many health care IPOs, and I have been primarily
16 responsible for several of them.

17 BAS has broad market experience, including expertise within the health insurance
18 industry, and more specifically, with Blue Cross Blue Shield (“BCBS”) companies. BAS
19 is the investment banking arm of Bank of America Corporation (“Bank of America”), one
20 of the world’s largest banks. With corporate relationships extending to over 95% of the
21 Fortune Domestic 500 and 78% of the Fortune Global 500, Bank of America is a leading
22 global financial institution.

1 BAS encompasses full service investment banking capabilities with leading debt,
2 equity and mergers and acquisitions products and services. BAS has been an underwriter
3 in more than 90 IPOs since 2000.

4 Since 2000, BAS Healthcare has participated in over 20 healthcare IPOs and three
5 health insurance IPOs. In addition, members of the BAS Healthcare team have
6 participated in the following BCBS transactions and represent over 45 years of
7 experience within the health insurance arena:

- 8 • 12 transactions for WellPoint Health Networks, including its conversion and IPO
- 9 • RightCHOICE sub-IPO from BCBS of Missouri
- 10 • Trigon conversion and IPO
- 11 • BCBS of Georgia conversion and sale to WellPoint Health Networks
- 12 • 8 transactions for Anthem, including its conversion and IPO, and its pending
13 merger with WellPoint Health Networks
- 14 • BCBS of Connecticut's sale to Anthem
- 15 • BCBS of New Hampshire's acquisition of Matthew Thornton Health Plan
- 16 • Community Mutual BCBS' sale to Anthem
- 17 • United Wisconsin Group's \$70 million and \$45 million follow-on offerings

18 **Q. Have you provided us with a current resume?**

19 A. Yes. A true and correct copy of my current resume, which was previously
20 produced in discovery as a document numbered OICEXP_BAS 01092, is attached hereto
21 as **Exhibit A** and incorporated herein by reference; it will be marked as a Premera
22 Hearing Exhibit.
23
24

Q. On what issues was Banc of America Securities asked to give an opinion?

A. We were asked to give opinions on the following questions:

- Is Premera's strategy of converting and accessing the public equity market reasonable?
- Will Premera be an attractive investment?
- Will Premera's proposed transaction structure and terms be acceptable to investors?
- What effect will Premera's issuance of new shares have on the Foundation shareholders?

We were later asked to update our opinions in light of the revisions Premera made to its Form A Statement ("Form A"), and in light of the observations of the OIC's consultants with respect to the revised Form A.

We found the answer to be yes to the first three questions. As for the issuance of new shares, we found that because the Washington Foundation and the Alaska Health Foundation (hereinafter collectively referred to as the "Foundations") and Premera have a common interest in increasing the value of the corporation, Premera's issuance of new shares may well increase the value of the Foundations' holdings.

Q. Can you summarize your testimony on the issue of whether Premera's strategy of converting and accessing the public equity market is reasonable?

A. It is reasonable for Premera to take advantage of its current financial position to access the public equity market to increase its strategic flexibility and execute its strategic objectives.

Companies raise capital for two broad reasons: (i) to fulfill specific near-term needs and (ii) to provide strategic flexibility. Companies are better able to raise capital when they are in a strong financial position. Successful companies often raise capital

1 before an actual specific need arises in order to achieve strategic flexibility. Over the last
2 13 years, the health insurance companies that undertook IPOs to raise capital for their
3 own use did not have a specific stated purpose for most of that capital, other than to
4 provide strategic flexibility. It is therefore reasonable and not at all unusual for Premera
5 to identify its intended use of capital as “general corporate purposes.”

6 Premera’s strategy of converting and accessing the public equity market is
7 advantageous for several reasons. First, Premera’s risk-based capital (“RBC”) level is
8 not only well below the BCBS system-wide average, but is one of the lowest among
9 BCBS licensees. A public offering will enable Premera to increase its RBC level without
10 selling strategic assets or increasing debt. Second, Premera will be able to raise operating
11 cash by issuing primary shares in the offering. Cash at the parent level, which is
12 maintained by all other public health insurance companies, provides financial flexibility
13 to support growth initiatives, to invest in infrastructure and to weather downturns in
14 company performance. Without access to the public markets and without financial
15 flexibility, Premera has limited options when capital is needed most, including times of
16 financial burden, or to support additional growth opportunities. Indeed, if Premera
17 waited until its capital needs were both critical and immediate, it would face risks of
18 having to pay significantly more to raise it (and dilute shareholders more) or, in fact,
19 might not be able to raise it at all

20 Additionally, gaining access to the public equity market should enable Premera to
21 facilitate raising future capital that may be necessary as the Company grows. If Premera
22 is blocked from this avenue of raising capital, it could well be forced to explore
23 possibilities of strategic partnerships, or even the sale of Premera to another company.
24

Q. Please summarize your opinion as to whether Premera will be an attractive investment?

A. Premera's rationale and performance metrics should satisfy investor expectations, taking into account past trends and current market conditions, and therefore, it should be viewed as an attractive investment.

Investors will invest in a company only if its qualitative and quantitative characteristics are compelling. If Premera undertakes an IPO, investors will analyze the strengths and weaknesses of its operations based upon what they view to be the important characteristics and core competencies of successful health insurance companies. In addition, investors will require that Premera have certain performance metrics, such as size, profitability, growth and margin, that are comparable to similar health insurance companies that have undergone this type of transaction.

Premera's IPO rationale is comparable to the rationales of other successful health insurance IPOs, and Premera's metrics fall within or near the range of nine recent health insurance companies that have undergone an IPO.

In Premera's amended Form A, Premera agreed to a number of two-year post-conversion economic assurances specific to the Washington market (see Exhibit E-8 to the amended Form A). These assurances, of limited scope and duration, would not appear to significantly affect the Company's ability to achieve its financial projections as laid out in the original Form A filing, and therefore would not affect our conclusion that Premera would be viewed by the market as an attractive investment. While these assurances in their current form and duration are not expected to place Premera at a disadvantage relative to its competitors in terms of its operational flexibility, a material

1 extension of these assurances could have a negative impact on Premera's attractiveness to
2 investors.

3 **Q. What is your conclusion as to whether Premera's proposed transaction**
4 **structure and terms will be acceptable to investors?**

5 A. Premera's proposed transaction structure and terms are similar to the structure and
6 terms of previous successful equity offerings, including WellPoint, RightCHOICE and
7 WellChoice and, on that basis, are likely to be acceptable to investors, taking into account
8 past trends and current market conditions. In its revised Form A filing, Premera has more
9 closely aligned its transaction structure and terms with those of WellChoice, the most
10 recent health insurance company to convert to a for-profit company and successfully
11 complete an IPO.

12 It is common in BCBS conversions to have a significant owner (in Premera's case
13 the Foundations). Investors are well versed in this type of transaction and have been
14 comfortable with such structures historically. Investors will use comparable company
15 transactional documents to evaluate a company's proposed transaction structure and
16 terms. Therefore, it is important for Premera to have a transaction structure and terms
17 that are similar to recent BCBS conversions which includes provisions to minimize the
18 impact of the Foundations on company management and regulate the divestiture of stock
19 in the Company by the Foundations. Without this structure, investors may ascribe a
20 lower valuation to Premera due to concerns regarding the Foundations not divesting their
21 shares in an organized and rational manner, as well as possible concerns over corporate
22 governance issues.

23 BAS' initial conclusion that the transaction structure and terms would be
24 acceptable to investors is not affected by the revisions contained in the amended Form A

1 because these revisions are consistent with the most recent BCBS conversion
2 (WellChoice). However, the OIC's consultants have recommended additional
3 governance terms and conditions that would expand the ability of the Foundations to
4 affect the management of Premera. The inclusion of some of such terms and conditions
5 in Premera's transaction documents would place at risk Premera's ability to use the "Blue
6 Cross" and "Blue Shield" trademarks licensed to it by the BCBSA. The loss of
7 Premera's BCBSA trademark rights would significantly impair the value of the
8 Company. The specific measures proposed by the OIC consultants and their effects on
9 the Company are discussed more fully in the Supplemental Report; however, the
10 particular changes the OIC consultants propose that raise this concern are:

- 11 • Each Foundation holding a 5% (less one share) block of voting stock outside of
12 their respective Voting Trust and Divestiture Agreements;
- 13 • The Foundations being entitled to vote all of their shares free of the restrictions in
14 the Voting Trust and Divestiture Agreements with respect to any shareholder vote
15 on a transaction involving a change in ownership of 20% or more of the
16 Company;
- 17 • The Foundations not being required to reduce their holdings to less than 80% of
18 the common stock outstanding within one year of IPO, and not being required to
19 follow an aggregate divestiture schedule which reduces their combined ownership
20 of common stock to 50% or less in the third year, to 20% in the fifth year and to
21 5% after 10 years.
- 22 • Each Foundation being entitled to nominate its own Director to the Premera
23 Board, or in the alternative, for the Alaska Health Foundation to have an observer
24 in addition to the Washington Foundation's Designated Member.

20 Even if the BCBSA were to consent to some or all of the above recommendations, BAS
21 does not believe that adopting them is likely to enhance the value of the Company in the
22 eyes of investors. Accordingly, Premera should not be asked to undertake any of them
23
24

1 because they would jeopardize its BCBS marks and therefore would impact the
2 Company's value to shareholders and the viability of the IPO.

3 **Q. What are your conclusions as to the effect of Premera's issuance of new**
4 **shares on the Foundations?**

5 A. The ultimate strategy of the Foundations is to maximize value upon
6 liquidation of shares, regardless of short-term ownership or earnings dilution. The value
7 to the Foundations is directly correlated to the success of Premera, and the Foundations'
8 and Premera's interests are therefore aligned in creating value for the Company.

9 If Premera uses the proceeds from the sale of initial shares in a strategic manner
10 to support growth, then raising primary capital in an IPO will increase value for the
11 Foundations as the value of the Company increases. Furthermore, it is possible for the
12 Foundations to realize greater value by allowing Premera to issue primary shares in the
13 IPO and waiting to sell secondary shares in a follow-on offering. For example,
14 WellPoint's split-adjusted IPO price was \$14.00 per share on 1/28/93. The Foundation
15 shareholder subsequently sold shares at \$14.00 (11/21/96), \$19.00 (4/7/97), \$36.00
16 (4/15/98) and \$40.50 (6/29/99) per share and realized greater value by selling shares in
17 follow-on offerings rather than at the time of the IPO.

18 **Q. Does this conclude your testimony?**

19 A. Yes it does.
20
21
22
23
24

Brian Kinkead
89 Edgemont Road
Montclair, NJ 07043
212.847.6274 (wp)
973.655.1814 (hp)
917.816.5512 (cell)
brian.m.kinkead@bofasecurities.com

Business Experience

- 2002-Present Banc of America Securities
Managing Director, Global Corporate and Investment Bank, Healthcare Group
Senior banker responsible for providing investment banking services to healthcare service companies and including managed care companies, and hospital supply companies
- 1998-July 2002 Morgan Stanley
Executive Director, Corporate Finance, Healthcare Group
Senior banker responsible for providing investment banking services to healthcare service companies, including managed care companies
- 1994-1997 Morgan Stanley
Executive Director, Public Finance, Healthcare Group
Head of banking team responsible for providing debt and merger and acquisition advisory services to not-for-profit hospitals, health systems and health maintenance organizations. Managed group of six professionals
- 1990-1993 Morgan Stanley
Vice President, Public Finance, Healthcare Group
Senior banker responsible for marketing and execution of tax-exempt debt transactions for not-for-profit hospitals and health systems
- 1986-1989 Morgan Stanley
Associate, Public Finance, Healthcare Group
Junior banker responsible for execution of tax-exempt bond transactions and assisting senior bankers market product to hospitals and health systems
- 1984-1986 Moody's Investors Service
Senior Analyst, Public Finance, Healthcare Group
Responsible for analysis of hospitals and healthcare systems to assign bond ratings
- 1980-1984 John Hopkins Center for Hospital Finance and Management
Research Consultant
Responsible for conducting and managing research consulting engagements

Education

- 1979-1984 John Hopkins University, School of Hygiene and Public Health
Doctor of Science Degree. Concentration in healthcare policy and economics. Co-authored book entitled Hospital Capital Formation in the 1980s
- 1975-1978 Leeds University, England
Masters of Arts Degrees. Concentration in Political Science and Healthcare Policy and Administration
- 1970-1974 Essex University, England
Bachelor of Arts Degree. Concentration in Social Studies. Graduated with high honors

Exhibit A

OICEXP_BAS 01092